Danger: Is Now the Time to Sell the Canadian Banks?

Description

Brace yourself; earnings season is coming.

The Canadian banks are just over a month away from pulling the curtain on their latest quarterly numbers, and they're going to be ugly. If this week's round of U.S. bank earnings is any indication for what's to come, Canadian bank investors may be compelled to sell before hideous results are revealed.

Are ugly U.S. bank earnings a sign of what's to come for Canadian bank stocks?

Some pretty underwhelming numbers were released by the U.S. banks this week, with **Wells Fargo** reporting quarterly earnings per share of just $0.01. Wells and the broader basket of bank stocks plunged violently on Wednesday, and the pain wasn't contained to that side of the border either! Shares of **Bank of Montreal** (TSX:BMO)(NYSE:BMO) pulled back 5% on the day over fears that the Canadian banks could be headed for the same fate come next month's bank earnings season.

It also didn't help that oil plunged (WTI briefly fell below US$20) yet again despite the end of the oil price war, with a new deal of production cuts. BMO, with its heavy exposure to Canadian crude companies, is expected to lead the downward charge with many analysts pointing the finger to those gross oil and gas (O&G) loans that could go sour in a hurry.

With the expectations set to the floor, though, I think the pessimism on BMO and other Canadian banks is overblown beyond proportion. The Canadian banks could test their March lows, as jitters mount over earnings season, and if they do, I'd back up the truck and start accumulating shares while they're at generationally cheap levels.

Don't underestimate the power of the Canadian banks

The Canadian banks are far too well capitalized to be held down for prolonged periods. Just look at how the banks (except **CIBC**) bounced back sharply from the Great Recession. Banks go bust when a crisis hits because everything falls back to them. When it comes time for the next phase of the market cycle, though, watch out, because the well-capitalized Canadian banks roar loud, taking their shareholders with them to the heights reached before the crisis.

Bank of Montreal sports a colossal 6.1% dividend yield after Wednesday's damage. And now is as good a time as any to start picking away at shares that are already factoring in a very painful quarter. Expectations are low — too low; there's a chance that BMO could stand to pop after the release of some better-than-feared numbers.

Moreover, should worse come to worst, it's not the O&G exposure that investors should be most worried about. It's the possibility of a Canadian housing collapse will occur. Fortunately, BMO isn't a Canadian bank that's most exposed to uninsured mortgages and with its stellar capital structure, I suspect that not even the worst economic quake will be able to threaten BMO's business or its dividend.

Foolish takeaway

The next few months are going to be ridiculously volatile. There's no doubt about that. COVID-19 and oil's continued collapse are going to pressure the Canadian banks, but if you're a long-term investor, look past the near- to medium-term uncertainties to the longer-term fundamental picture. You may take on some pain now, but it'll be worth it once you've locked in your outsized dividend yield, and banks make a move back to the top on the back of a new bull market.

Don't sell the Canadian banks here if you're a long-term investor who's willing to hold for at least five years. Now is the time to be buying, despite the massive uncertainties while rock-bottom valuations exist alongside absurdly low expectations.

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